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BEFORE THE

Federal Communications Commission

WASHINGTON, D.C.

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OCT 29 1999
FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of	)	
	)	
Access Charge Reform	)	CC Docket No. 96-262
	)	
Price Cap Performance Review for Local Exchange Carriers	)	CC Docket No. 94-1
	)	
Interexchange Carrier Purchases of Switched Access Services Offered by Competitive Local Exchange Carriers	)	CCB/CPD File No. 98-63

COMMENTS OF TIME WARNER TELECOM

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ATTORNEYS FOR TIME WARNER TELECOM

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COMMENTS OF TIME WARNER TELECOM

Time Warner Telecom ("TWTC"), by its attorneys, hereby files these comments in response to the Notice of Proposed Rulemaking ("Notice") in the above-captioned proceeding.

I. INTRODUCTION AND SUMMARY

In the Notice, the Commission seeks comments on a host of issues dealing with the extent to which it should deregulate ILECs and regulate CLECs. Many of the proposals suggested in the Notice have some theoretical plausibility and merit at least some discussion. But taken as a whole, the Notice reflects an extremely disturbing tendency. In the recent past, specifically in the Fifth Report and Order and in the Notice, the Commission seems to have lost sight of the fundamental policy underlying the Telecommunications Act of 1996: that enabling entry by competitors with lower cost curves and innovative offerings provides many more consumer benefits than permitting ILECs to retain their vast market power.

From this simple proposition, many conclusions and presumptions should follow. First, the Commission should avoid regulating CLECs wherever possible. The long distance carriers have raised the theoretical possibility that CLEC access charges may in some cases be unreasonable because CLECs may have exploited a "third party pays" situation. But if this situation has indeed ever existed for originating access, it is fast disappearing. As the telecommunications market is transformed into one in which carriers must compete in the provision of bundled local and long distance services, virtually all originating access will become subject to competitive pressures. The Commission must not impose regulations on new entrants to address a non-existent or quickly disappearing problem.

While it may take longer for market pressures to affect terminating access, the Commission must only intervene here if it finds evidence of widespread abuse in the record and then only to the extent that it requires CLEC terminating access rates to be no higher than originating access rates. In no event should the Commission allow IXCs to refuse to pay CLECs for access service and to use their leverage to dictate access charge rates to CLECs. As the bedrock provisions of the 1996 Act (Sections 251 and 252) show, competition will never develop if negotiations between carriers with significant differences in market power are left unregulated. The appropriate regulatory approach here is to establish a clear policy that the sole means by which an IXC may challenge CLEC access charges is a Section 208 complaint. Where such complaints are brought, the Commission should set an especially high burden of proof for any IXC attempting to show that either of the following is unreasonable: (1) a CLEC's originating access rates, or (2) a CLEC's terminating access rates, where such rates are no higher than its originating rates.

Furthermore, the Commission must err on the side of retaining regulation applicable to ILECs rather than on letting go too soon and creating opportunities for exclusionary pricing behavior. It is disturbingly ironic that the Commission has sought comment on CLEC regulation just after inappropriately adopting extensive pricing deregulation for ILECs and while seeking comments on further ILEC deregulation. Such deregulation is premised on the assumption that CLEC entry into the access market exerts competitive pressure on ILEC rates. Of course, if this is true, then ILECs in turn place pressure on CLEC rates and no regulation of CLECs is warranted. Unfortunately, the Commission has overstated the extent to which CLEC entry disciplines ILEC rates and understated the extent to which ILECs, and IXCs, discipline CLEC rates.

Indeed, the most costly market failure will come from ILECs exploiting their newfound and excessive pricing flexibility. TWTC does not expect the Commission to alter the framework for ILEC deregulation adopted in the Fifth Report and Order. But the Commission can at least avoid creating further unnecessary opportunities for ILECs to harm competitive entry with exclusionary pricing behavior. Specifically, the Commission should not allow ILECs to deaverage their common line basket services except where enough competitive entry has occurred to prevent predation or where unbundled loops have been deaveraged. In addition, the Commission should establish a high hurdle for obtaining Phase II pricing flexibility for common line and switching services: ILECs should be required to demonstrate that CLECs offer service to 75 percent of the customer locations in the MSA over their own facilities and that 15 percent of those customer locations are actually being served by CLECs over their own facilities.

Finally, the Commission should abandon its suggestion that a capacity-based rate structure be adopted for ILEC switching under Part 69. There is no evidence that capacity-based pricing will more closely match optimal peak load pricing than the current per minute rate structure.

II. CLEC ORIGINATING ACCESS CHARGES SHOULD NOT BE CONSTRAINED BY FCC REGULATION; CLEC TERMINATING ACCESS SHOULD AT MOST BE CONSTRAINED BY THE REQUIREMENT THAT IT BE SET NO HIGHER THAN ORIGINATING ACCESS.

In the Notice, the Commission seeks comments on a broad range of issues regarding CLEC access charges that all boil down to whether CLECs are able to take advantage of a market failure in the provision of originating and terminating interstate access. The concern is that the CLECs' local service customers do not themselves pay access charges. Thus, it has been suggested that CLECs are able to take advantage of a "third party pays" situation and set access charges without any market constraint. While much of the discussion in the Notice on this issue addresses both originating and terminating access, the two are quite different and should be addressed separately.

A. The FCC Should Not Take Any Action With Regard To Originating Access.

On the originating side, the Commission should be very skeptical of IXC claims that CLECs are systematically exploiting a market failure. This is because the long distance carriers have many ways of forcing CLECs to respond to market pressure on originating access. For example, IXCs can, and do to a significant extent, offer their larger customers (to which CLECs primarily market their service) incentives to bypass originating switched access charges altogether by connecting to the IXC POPs via special access circuits. Such incentives can be offered without the IXC ever entering the local market. In addition, most of the major IXCs also have large CLEC operations of their own, such as MCI's MFS and Brooks Fiber and AT&T's TCG and ACC. There is every reason to believe that the IXCs could use these CLEC operations to offer attractive bundled offerings of local and long distance to customers served by CLECs that overprice their originating access.[1]

Notwithstanding the long distance carriers' substantial opportunities to address the problem, any remaining theoretical concern about a third party pays situation on the originating

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[1] As explained in Section II.B <u>infra</u>, IXCs can also use their leverage as large purchasers of dedicated transport from CLECs to insist on lower switched rates from CLECs. This point is equally relevant to the originating and terminating sides. As also discussed in Section II.C <u>infra</u>, while the forms of IXC self-help suggested here are appropriate, IXCs should not be permitted to limit customer choice by <u>refusing</u> to provide long distance to customers that take their local service from certain CLECs.

side will disappear in the near future. This is so for two fundamental reasons.

First, the rules the Commission recently established in the Fifth Report and Order to implement a phased deregulation of ILEC access charges could significantly reduce the number of customers served by CLECs that connect to their long distance carriers on the originating side through switched access arrangements. The Commission has itself concluded that its new rules will spur increased competition by allowing "incumbent LECs progressively greater pricing flexibility as they face increasing competition."[2] The effect will likely be most dramatic for dedicated special access services, where no potential third party pays problem exists. As those services are priced lower and lower, the economics of using dedicated access become more favorable, particularly for large and medium sized businesses. As the market price drops for these dedicated service offerings, the set of customers addressable by CLECs that connect to long distance carriers through originating switched access arrangements could diminish substantially. The scope of the "third party pays" problem will be reduced accordingly.

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2 See Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Interexchange Carrier Purchases of Switched Access Services Offered By Competitive Local Exchange Carriers; Petition of U S West Communications, Inc. for Forbearance from Regulation as a Dominant Carrier in the Phoenix, Arizona LATA, CC Docket Nos. 96-262, 94-1, CCB/CPD File No. 98-63, CC Docket No. 98-157, Fifth Report and Order, ¶ 67 (rel. Aug. 27, 1999) ("Fifth R&O").

Furthermore, as the market for dedicated access arrangements forces prices down, CLECs will have the incentive to lower their switched access prices. Long distance carriers and their customers assess whether to bypass switched access with dedicated transport based on the differential in the prices for those facilities. Where the differential is large enough, the parties have the incentive to move to dedicated access. To keep access traffic on their switched networks, therefore, CLECs will need to respond to lower special access rates with lower originating switched access rates. In this manner, the competitive pressures on originating switched access should become more evident fairly soon.[3]

Second, the conditions that have made it possible for carriers to support stand-alone offerings for local and long distance services are quickly disappearing. In the near future, carriers will be forced to offer most of their customers bundled packages of local and long distance, as well as possibly other services such as wireless and broadband, in order to compete and survive. When such bundles become standard, the opportunity for

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3 Of course, those pressures are likely to be excessive in many cases since the ILECs have now been given the opportunity to engage in exclusionary pricing strategies. Indeed, the regulators' attention should be focused on the threat of exclusionary behavior, which is ultimately far more detrimental to consumer welfare, than high access rates charged by CLECs. Exclusionary behavior is more harmful because it prevents entry for all services over time and in large geographic areas. High CLEC access charges (assuming they exist) only affect one set of customers and in any event are a temporary phenomenon.

CLECs to capture customers for local service alone and then overcharge for switched access will largely disappear.

The transformation of the market into one in which carriers offer competing bundles of service to most customers is both inevitable and imminent. Numerous marketing studies support the conclusion that both residential and business end users would prefer to purchase all of their telecommunications needs from a single source. For example, a 1997 study found that 70% of consumers would prefer to purchase all of their telecommunications needs from a single source.[4] Market data from the United Kingdom and Canada further demonstrate that a significant percentage of consumers will choose one-stop shopping packages when they are made available.[5]

Bundling local and long distance also makes sense because the two services can often be provided together more efficiently than separately. As Professors Kahn and Tardiff have argued, many of the same facilities and personnel are used in the provision of the two services.[6] Kahn and Tardiff argue that BOCs

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4 See Communications Daily, Jan. 2, 1997.

5 See Declaration of Jerry A. Hausman at ¶ 6, filed in support of Application by BellSouth Corporation, et al. Pursuant to Section 271 of the Communications Act of 1934, as amended, to Provide In-Region, InterLATA Services in Louisiana, CC Docket No. 97-231.

6 See Affidavit of Alfred E. Kahn and Timothy J. Tardiff at ¶ 30, filed in support of the Application of SBC Communications Inc., Southwestern Bell Telephone Company, and Southwestern Bell Communications Services, Inc. d/b/a Southwestern Bell Long Distance for the Provision of In-Region InterLATA Services in Oklahoma, CC Docket No. 97-121.

are especially well-placed to compete in the long distance market because "the incremental customer costs of adding long-distance to their present mix of services is small." Id. at ¶ 29 (emphasis omitted). Once the Section 271 checklist requirements are met, the same can be said of other carriers. That is, in the absence of artificial barriers to entry into the local market, all carriers will be able to provide local and long distance in combination more efficiently than as separate offerings. This is the essence of economies of scope.

Not surprisingly, Wall Street analysts have come to expect carriers to move toward a bundling strategy in the near future. Morgan Stanley's telecom analyst observes that "[p]roviding the 'bundle' is the Holy Grail of telecoms" for large telecommunications providers.[7] Morgan Stanley reports the same trends for CLECs. Among the "salient trends" it has identified this year for CLECs is that "[s]ales of bundled products are crucial in growing revenue per line, increasing product diversity, and reducing churn."[8] Morgan Stanley concludes that CLECs that are unable to provide bundles of local and long

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7 See Morgan Stanley, Dean Witter Industry Report, "Telecommunications Services: Large Cap Company Coverage" June 16, 1999 at 14 ("Morgan Stanley Large Cap Industry Report"). For businesses, the bundle means "delivering solutions to customers to solve their communications needs, up to and including full outsourcing." Id. For the "consumer market" this means, "providing some combination of local, long distance, wireless, video, and even security monitoring." Id.

8 See Morgan Stanley, Dean Witter Industry Report, "Telecommunications Services: CLECs/Return to the New Paradigm" June 9, 1999 at 1, 2.

distance are much less likely to succeed in the near future. See id. at 10. In fact, one analyst recently concluded that stand-alone long distance offerings will disappear almost entirely in the near future:

> we do not see long distance voice remaining a sustainable stand-alone business. Barriers to entry have diminished, particularly on the consumer side, and the cost to transport voice continues to drop. Moreover, the trend is toward bundling 'free' long distance with other services such as local or wireless.[9]

The major long distance carriers are all working quickly to prepare their own bundled offerings of local and long distance, as well as possibly other services. For example, AT&T is aggressively promoting several one-stop shopping packages designed for business and residential customers. As to business, AT&T states that "end-to-end offers for both switched and dedicated-access that include local, IntraLATA, inbound and outbound long distance services" permit customers to increase productivity, standardize billing, obtain a single point of contact for customer support.[10] Sprint is meanwhile rolling out its Integrated On-Demand Network ("Sprint ION") service which offers local and long distance voice as well as broadband over an

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9 See CIBC World Markets Corp., Industry Report, "Telecom Services: Strong Volume Growth In 2Q99," Aug. 4, 1999 at 13 ("CIBC Report").

10 See http://www.att.com/local/faq/faq.html (Oct. 12, 1999). Of course, AT&T plans ultimately to offer bundled services in many areas over cable facilities. Because of its facilities-based CLECs, it is already able to offer such services to most large business customers.

integrated platform.[11] Sprint ION is being offered initially to large business customers and will gradually made available to residential and small business.[12] Moreover, both Sprint and MCI have been aggressively purchasing wireless cable companies as a means of establishing a "third pipe" for the provision of bundled local and long distance services.[13]

The IXCs are of course all responding as one would expect to the increased level of Section 271 checklist compliance among the BOCs. As the CIBC telecommunications analyst has noted, bundled offerings "will likely become the norm as the RBOCs begin to enter these markets in early 2000." On the one hand, BOC compliance with the checklist, especially the provision of non-discriminatory access to OSS, makes it more efficient for CLECs, including the major IXCs, to offer bundled local and long distance services. On the other hand, Section 271 approval of course will also give BOCs the ability to enter the market of bundled services immediately. Such entry now seems likely within

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11 See "Sprint to Offer Nation's First Integrated Communications Services for the Home; Denver, Kansas City and Seattle Residents First to Experience Sprint ION(SM)," PR Newswire (June 21, 1999) (describing Sprint ION's integration of local, long distance and data).

12 See "Sprint Activates 17 Service Nodes to Connect Customers Nationwide to Sprint ION(SM) Applications and Services; Deployment Enables Sprint ION Availability Nationwide for Large Businesses That Want to Gain a Competitive Advantage in the Emerging Networked Economy," PR Newswire (Sept. 30, 1999) (announcing rollout of Sprint ION to large businesses).

13 See "MCI WorldCom And Sprint: Starry-Eyed Over Wireless Cable Companies," Broadband Networking News (May 11, 1999).

the next twelve months in several key states, such as New York, Texas, Georgia and California.

The BOCs have made it clear that they are desperate to offer bundled of local and long distance services as soon as possible. In part this is due to the value of entering the market first on a widespread basis and obtaining a valuable "first mover advantage." Ameritech and U S WEST have already attempted to enter the market for bundled services prior to meeting the requirements of Section 271 by joint marketing their local and intraLATA services with Qwest's long distance service.[14] In their Section 271 applications, the BOCs have also described their detailed plans to bundle local and long distance.[15]

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14 See AT&T Corp. v. Ameritech et al., Memorandum Opinion and Order, 13 FCC Rcd 21438 (1998) (holding that the joint marketing plans between U S WEST and Qwest and Ameritech and Qwest violated Section 271) aff'd U S WEST Communications, Inc. v. FCC, 177 F.3d 1057 (D.C. Cir. 1999) ("BOC Joint Marketing Order"). The Commission found that U S WEST and Ameritech entered their joint marketing relationships with Qwest for the specific purpose of joint marketing local and long distance service in their regions. See BOC Joint Marketing Order at ¶¶ 9, 14. The BOCs were motivated by the substantial benefits of obtaining first mover advantage in providing local and long distance bundles. See id. at ¶ 9 (quoting Ameritech representatives as having entered into the joint marketing to establish "first mover's advantage as a way to 'beat [the] Big-3 IXCs to the mass market with a full service offer before IXCs can leverage their customer relationships to sell local'").

15 For example, in a Declaration filed in support of Bell Atlantic's recent Section 271 application for New York, Professor Paul W. MacAvoy argues that a central public interest benefit of Bell Atlantic's entry in the in-region interLATA market will be that Bell Atlantic "along with the incumbent long-distance providers will be free to offer to customers innovative service bundles that combine together local, long-distance, and other services into the sort of 'one-stop' shopping customers prefer." See Declaration of Paul W. MacAvoy in support of Application by New York

The BOCs are sure to be formidable rivals in the provision of bundled local and long distance services. Their brand name recognition and entrenched position as local carriers will give them powerful means of tying up customers with bundles. For example, the U S WEST/Qwest so-called "Buyer's Advantage" joint marketing plan was enormously successful while it was allowed to remain in effect, winning about 130,000 subscribers in less than one month. See BOC Joint Marketing Order at ¶ 16. If BOCs and their rivals are able to offer such promotions on a long-term basis, the market will indeed be transformed.

All of this evidence makes clear that the telecommunications market is in the initial stages of a fundamental transformation in which the "huge divide that once separated the local and long distance businesses is rapidly becoming a thing of the past." See Morgan Stanley Large Cap Company Coverage Industry Report at 9. It is this divide that has made it theoretically possible for CLECs to take advantage of a third party pays distortion on the originating access side. But where all of the major carriers provide local and long distance as an integrated package, CLECs will be forced to follow.

Moreover, it would be extremely unwise for the Commission to attempt some form of regulatory intervention to fix distortions created by stand-alone originating access offerings just when

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Telephone Company (d/b/a Bell Atlantic - New York), Bell Atlantic Communications, Inc., NYNEX Long Distance Company, and Bell Atlantic Global Networks, Inc. for Authorization to such offerings are quickly becoming a thing of the past. Regulations designed to address this issue would likely require CLECs to somehow publicize rates that at the very least do not exceed some form of price ceiling. Such reporting would undoubtedly impose costs on CLECs. Further, given the considerable level of deregulatory measures the FCC has taken for ILECs in the recent Fifth R&O, it would be extremely inappropriate to now impose new regulations on CLEC to address what is at most, if at all, a temporary problem.[16]

The Commission must therefore rely on its authority to make informed predictive judgments as the basis for regulatory decisions to forbear from regulating CLEC originating access.[17]

Provide In-Region, InterLATA Services in New York, CC Docket No. 99-295 at ¶ 9.

16 It is worth emphasizing that it would be patently arbitrary for the Commission to deregulate ILEC rates based on a finding that ILECs must be allowed to respond to CLEC competitive entry and at the same time to regulate CLEC rates based on the finding that CLEC rates are not subject to competitive pressures. To the extent that interstate access services are subject to competition, that competition affects both ILECs and CLECs. These services cannot be competitive when provided by ILECs but not when provided by CLECs. It follows that if the Commission does decide that it must regulate CLEC rates, then virtually all of the deregulatory measures adopted in the Fifth R&O must be vacated.

17 It has long been established that the FCC may base its decisions on informed predictive judgments. See, e.g., FCC v. WNCN Listeners Guild, 450 U.S. 582, 594-96 (1981) (acknowledging that the FCC's decisions must sometimes rest on difficult predictive judgments rather than pure factual determinations); NAACP v. FCC, 682 F.2d 993 (D.C. Cir. 1982) ("greater discretion is given to administrative bodies when their decisions are based upon judgmental or predictive conclusions").

The Commission has relied on many such predictive judgments as the basis for deregulating ILECs, notwithstanding the material possibility that the ILECs might be able to exploit their market power.[18] It would stand the logic and policies of the Communications Act on their heads were the Commission to err on the side of deregulating ILECs, while imposing new regulation on CLECs.

B. The FCC Should Proceed Cautiously In Considering Constraints On CLEC Terminating Access And Should At Most Require CLECs To Limit Their Terminating Rates To No Higher Than Their Originating Rates.

On the terminating side, the issue is somewhat more complex. As the Commission has recognized, a long distance carrier that originates a call has no customer relationship with the called party and has a more difficult time influencing the called party's selection of local carriers.[19] For these reasons, at

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18 For example, in the Fifth R&O, the Commission decided to (1) to remove corridor and interstate intraLATA toll services from price cap regulation based on its predictive judgment that "price cap LECs will be unable to exploit any individual market power over a sustained period" (¶ 56); (2) permit more extensive geographic deaveraging for trunking basket services without any ILEC demonstration that such deaveraging is reasonable based on a presumption that "market forces" along with certain other protections will prevent ILECs from establishing unreasonable pricing zones (¶ 65); and (3) more broadly, to allow ILECs extensive pricing flexibility based on the predictive judgment that the competitive triggers adopted in the order will be adequate to protect against strategic pricing behavior (¶¶ 79-80).

19 See Notice at ¶ 236; Access Charge Reform; Price; Price Cap Performance Review for Local Exchange Carriers; Transport Rate Structure and Pricing; Usage of the Public Switched Network by Information Service and Internet Access Providers, CC Docket No. 96-262, Notice of Proposed Rulemaking, 11 FCC Rcd 21354, ¶¶ 271, 279 (1996) ("1996 Access Charge NPRM").

least in the short run, the increased competitive pressures that are transforming the originating side are less likely to affect terminating access.

It is important to emphasize, however, that long distance carriers are not completely without remedies where they face high terminating access charges. Most obviously, IXCs can diminish the problem by entering the local market and winning local customers of their own. See 1996 Access Charge NPRM at ¶ 272. In addition, IXCs can use their leverage as large purchasers of dedicated transport from CLECs to insist on lower terminating rates.[20]

Furthermore, as the Commission has recognized, long distance carriers may offer incentives to end users to whom they deliver traffic to use LECs with low terminating access charges. As the Commission has explained,

> [W]e believe that overcharges for terminating access could encourage access customers to take competitive steps to avoid paying unreasonable terminating access charges. . . . Although high terminating access charges may not create a *disincentive* for the call recipient to retain its local carrier (because the call recipient does not pay the long distance charge), the call recipient may nevertheless respond to *incentives* offered by an IXC with an economic interest in encouraging the end user to switch to another local carrier. Such an approach could have particular impact when the IXC [such as AT&T] has significant brand recognition among consumers. Moreover, as noted in the NPRM, excessive terminating access charges could encourage IXCs to enter the access market in an effort to win the local customer.

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20 See Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Transport Rate Structure and Pricing; End User Common Line, First Report and Order, 12 FCC Rcd 15982, ¶ 361 (1997) ("First R&O").

See id. at ¶ 362 (emphasis in original). AT&T, for example, already encourages high volume customers to adopt terminating bypass practices by offering to contract with them to complete their calls on their own T1.5. AT&T advertises that it will compensate these customers on a per-minute basis and will send them monthly checks.[21] Similarly, AT&T and other IXCs could offer incentives to end users to switch local carriers.[22]

Beyond such short-term solutions, it seems likely that the market transformation into competing bundled offerings will be accompanied by other developments that largely eliminate the terminating access problem. That is, as larger carriers begin serving more and more customers for local and long distance, they will increasingly terminate access traffic for each other. There will be less incentive for a carrier to overcharge for termination in this context because other carriers are likely to respond with similarly overpriced terminating charges. Competing providers of bundled services will therefore eventually have the incentive to negotiate cost-based mutual termination agreements for toll traffic. Where this is so, terminating access would come to resemble local transport and termination. As with such local interconnection, regulators will not need to worry so much about the exploitation of a terminating bottleneck. Rather, they

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21 See <www.att.com/t1/access>.

22 See First R&O at ¶ 362 (call recipient may respond to incentives by an interexchange carrier with an economic interest in encouraging the end user to switch to another local carrier).

will need to ensure that carriers with small numbers of customers are able to exchange traffic on reasonable terms and conditions with larger carriers. This long term scenario is therefore more threatening to small CLECs than to large IXCs.

Notwithstanding this likely long-term result, if the Commission decides that it must intervene in the short term to constrain CLEC terminating rates, it must do so in the least intrusive way possible. The Commission has appropriately stated its strong preference for market-based solutions to access charge problems. See Notice at 247. The best way to marshal market forces to prevent unreasonable terminating access rates is to require CLECs to charge a rate for terminating access that is no higher than the rate for originating access. This approach would take advantage of the increasing market pressures that CLECs will experience on the originating side and simply force CLEC terminating access prices to respond to the same pressures. Indeed, the Commission has in the past relied on the fact that CLEC rates for originating and terminating access have been set at similar levels as evidence that there was no need to regulate CLEC terminating access. See First R&O at ¶ 360. The long distance carriers will no doubt argue that such reliance was misplaced where CLEC originating access charges were not subject to enough market pressure. But as demonstrated above, that argument is no longer persuasive.

In sum, the purported market failure associated with CLEC terminating access may not be as serious as the long distance carriers would have the Commission believe and will in any event disappear over time. But if the Commission feels the need to impose some constraints in the interim, it should do so only by requiring CLECs to charge terminating rates that are no higher than originating access rates.

C. Long Distance Carriers Seeking To Challenge CLEC Access Charges Should Rely On The Section 208 Complaint Process.

In no event, however, should the Commission address either the originating or the terminating access issue by allowing long distance carriers to "negotiate" access rates with CLECs. This would be the result if the Commission were to allow long distance carriers to refuse access service from certain CLECs, see Notice at ¶¶ 242-243, or if the Commission were to mandatorily detariff CLECs, thus preventing them from relying on the filed rate doctrine to recover access charge fees, see id. at ¶ 246. Both of these proposals would allow long distance carriers such as AT&T the freedom to use all of the leverage at their disposal to dictate to CLECs both rate levels and rate structures. This result is bad policy, inconsistent with established Commission policy regarding intercarrier relationships and should not be permitted.

Surely the Commission agrees that it should not give large long distance carriers such as AT&T the right to stand in the shoes of the regulator and unilaterally dictate CLEC access rates. Yet this is precisely what would happen if CLECs were forced to negotiate access rates charged to the large IXCs. No CLEC could possibly offer local service subject to the qualification that it would not allow subscribers to presubscribe to AT&T or other large IXCs or receive calls from others that have presubscribed to such IXCs. To stay in business, CLECs would be forced to accept whatever rates AT&T prescribes for the provision of interstate access.

Indeed, this is precisely what AT&T and other IXCs are already trying to achieve. As the Commission is aware, many of the large long distance carriers have either refused or threatened to refuse to pay CLEC access charges unless those charges conform to the IXCs' notions of reasonableness. The IXCs have in essence sought the right to set rate levels for CLECs. Absent regulatory intervention, the IXCs' power to dictate CLEC rates in this manner is limited only by the extent of their bargaining power. In the case of carriers like AT&T, that bargaining power is substantial.

Permitting this behavior is also inconsistent with the policies of the 1996 Act. As the terms of Section 251 and 252 of the Act demonstrate, where substantial differences in bargaining power between two carriers exist, close regulatory oversight is appropriate.[23] Absent such supervision, new entrants would be

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23 <u>See</u> <u>Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers</u>, First Report and Order, 11 FCC Rcd 15499, ¶ 55 (1996)("The inequality in bargaining power between incumbents and new entrants militates in favor of rules that have the effect of equalizing bargaining power") ("<u>Local Competition First Report and Order</u>"). The analogy to Sections 251 and 252 is not perfect because those provisions address negotiations between competitors with unequal bargaining power. Nevertheless, the broader principle that regulatory intervention in appropriate in cases of significant inequalities in bargaining power between carriers is fully relevant here.

unable to establish stable and reasonable terms for interconnecting with and exchanging traffic with incumbent carriers like AT&T that have large customer bases.

Finally, the Commission should be concerned about the manner in which customer choice could be artificially limited if IXCs are permitted to force their customers to choose between their CLEC and the IXC. Customers should be given as much freedom as possible to purchase their services in bundles or as stand-alone offerings from the carriers of their choice. Some CLECs that have not yet begun offering bundled services may still be desirable to local customers because of superior customer service or superior network reliability. IXCs should not be given the power to limit these customers' ability to purchase local service from such CLECs in combination with the IXC of their choice.[24]

Thus, given the significant dangers associated with unleashing IXCs to use the full measure of their opportunities for self help, the Commission should prohibit IXCs from refusing to pay any part of the access charges due to CLECs under any relevant tariffs or contracts. This approach is consistent with the Commission's policy against allowing carriers to resort to

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24 This is not to say that IXCs should not be allowed to offer their customers financial incentives either to purchase bundled offerings from the IXCs or from another LEC with lower access charges. Such offers are all part of the competitive process. TWTC is simply worried about the consequences of allowing IXCs to <u>refuse</u> to provide service to customers so long as they subscribe to certain CLECs for local service.

self-help.[25] The Commission should also prohibit IXCs from refusing to provide service to customers who subscribe to particular CLECs.

The Commission should instead require that IXCs use the Section 208 complaint process to address any complaints they may have with CLEC access charges. Moreover, in reviewing such complaints, the Commission should apply a higher burden of proof than would normally apply in a Section 208 complaint where an IXC seeks to demonstrate that (1) a CLEC's originating access rates are unreasonable, or (2) a CLEC's terminating rates are unreasonable, where such terminating rates are no higher than the CLEC's originating rates. In this way, the Commission can address extreme, outlying CLECs while at the same time preserving appropriate means of traffic exchange among carriers and customer choice.

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25 See Elkhart Tel. Co. v. Southwestern Bell, File No. E-93-95, Memorandum Opinion and Order, 11 FCC Rcd 1051 at ¶ 34 (1995)("[C]arriers who are requested to provide services should make all efforts to do so, such as providing them under protest pending the resolution of complaints, petitions, or litigation, rather than refusing to meet a questionable obligation until after the complaint or litigation is resolved. Those who choose the course of non-compliance are on notice that they will be acting at their own peril, should the question of the legitimacy of their refusal to meet their common carrier obligations be decided against them.")(quoting Hawaiian Tel. Co., File No. TS 9-79, Declaratory Order, and Notice of Apparent Liability, 78 FCC2d 1062, ¶ 9 (1980)).

III. THE FOCUS OF PHASE II PRICING FLEXIBILITY FOR COMMON LINE AND TRAFFIC SENSITIVE SERVICES SHOULD BE ON PREVENTING EXCLUSIONARY PRICING BEHAVIOR.

The Commission also seeks comments regarding the appropriate trigger and pricing flexibility relief for Phase II of its pricing flexibility regime for common line and traffic sensitive services. See Notice at ¶¶ 200-206 These two issues are of course closely interrelated. As the Commission recognized in the Fifth R&O, pricing flexibility, if prematurely granted, allows ILECs to "exclude new entrants from their markets." Fifth R&O at ¶ 68. See also id. at ¶ 79 (describing monopolists' incentive "to engage in exclusionary pricing behavior.") The trigger must therefore require enough competition to have developed to prevent "ILECs from successfully pursuing exclusionary strategies" once they receive Phase II pricing flexibility. Id. at ¶ 69.

As an initial matter, TWTC fundamentally disagrees with the approach the Commission adopted for defining triggers in the Fifth R&O and urges the Commission not to use that approach here. As TWTC has explained in this proceeding, the Commission should not have allowed the pricing flexibility permitted in Phase I (e.g., contract-based pricing) until the ILEC demonstrates that it lacks market power in the provision of the services for which it has received regulatory relief.[26] Rather than take this approach, the Commission adopted triggers that only require that the ILEC face competitive entry in a small percentage of the

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26 See Comments of Time Warner Communications Holdings, Inc., filed in CC Docket Nos. 96-262, 94-1, 91-213, 96-263 (Jan. 29, 1997) at 31-33.

customer locations in the geographic area (metropolitan statistical area or MSA) for which it obtains relief. As the Commission quite openly acknowledged with regard to special access and dedicated transport,

> because we will evaluate pricing flexibility requests on an MSA basis and do not require the presence of competitive facilities in every wire center in an MSA, there remains a theoretical possibility that an incumbent LEC could use pricing flexibility in a predatory manner to deter investment in competitive facilities in those wire centers where it as yet faces no competition.

Fifth R&O at ¶ 83. Notwithstanding this risk, the Commission decided to dispense with its traditional market power test. It preferred to err on the side of administrative simplicity and on the side of granting too much rather than too little pricing flexibility. TWTC submits that the Commission has its priorities backward. Given the substantial welfare benefits of efficient entry, the Commission's pricing flexibility rules should err on the side of preventing exclusionary behavior by applying the market power test or at least by requiring that entry be present in a larger portion of the market than has been required thus far.

The Phase I trigger the Commission adopted for traffic sensitive, common line and traffic sensitive components of tandem switched transport ("common line and switching") illustrates the point. In the Fifth R&O, the Commission decided to set the trigger for Phase I pricing flexibility for these elements as the requirement that competitors offer service to 15% of the customer locations over the competitors' own facilities. See id. at ¶ 108 Thus, the Commission has allowed ILECs to receive, inter alia, contract-based pricing authority for these services where the ILEC apparently faces no competition for the services in question in 85 percent of the market where the contract-based pricing is permitted. Surely the threat of exclusionary pricing under these circumstances is more than simply "theoretical."

The Commission should not make this already dangerous situation worse by adopting an overly lenient trigger for Phase II relief for common line and switching. For example, the mere offering of service is, by itself, inadequate evidence that competitors can actually compete effectively with the ILEC. There may well be cases where service is offered, but because of ILEC discriminatory behavior, the competitive service is degraded and therefore not an effective constraint on the ILEC. For example, TWTC offers service in several markets in which its ability to serve new customers is constrained by ILECs' reluctance or inability to provide adequate capacity on interconnection trunks. The ILECs have also been chronically delinquent in complying with the Commission's most recent collocation order. Because of such problems, the Commission should include in the Phase II trigger a showing that competitors are not just offering service but are able to win customers. In addition, the trigger should require that CLEC service is offered to most customer locations to limit the ILEC opportunities for cross-subsidy that would otherwise exist (for example if the percentage were only 50%).

Specifically, the Phase II flexibility should be triggered only upon a demonstration that switched services are offered to

75% of customer locations by competitors over their own facilities, and that service is actually provided to 15% of customer locations by competitors over their own facilities. These combined requirements will go some way towards to limiting the opportunities for cross-subsidy and predation. Increasing the percentage of the market for which a competitive alternative is offered will reduce ILECs' ability to raise prices in parts of the MSA to cross-subsidize prices for the same access elements elsewhere. Moreover, setting the trigger at 75% will make it extremely unlikely that CLECs will engage in strategic behavior to avoid surpassing the trigger for the percentage of customer locations to which service is offered.

The requirement that competitors have actually won a certain percentage of the market will also demonstrate that the ILEC has not succeeded in leveraging its control of wholesale inputs for its competitors to prevent them from competing on an equal footing.[27] Only in such a case should the Phase II relief adopted for other access elements in the Order be applied to common line and switching elements.[28]

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27 It is important to note that the requirement that 15% of customer locations be served by a CLEC means only that a CLEC must be providing some part of the service purchased at the customer location. The CLECs' market share is therefore likely to be far lower than 15% when this part of the trigger is met.

28 While the Commission expresses concern in the Notice that CLECs may not be willing to provide actual numbers of customer locations served in a particular area, See Notice at ¶ 120, this is less of a problem than it might appear. The Commission can require CLECs to provide this information periodically and on a confidential basis. The Commission can then inform an ILEC when the benchmark has been met in a

Nor should the Commission allow an ILEC to obtain Phase II relief for particular classes of end users. To begin with, this approach would make implementation and monitoring of pricing flexibility more costly and complex. Furthermore, such an approach would, as the Commission found with regard to Phase I relief, undermine its goal of encouraging competition for all classes of customer. There is therefore no need to adopt such an approach.

Finally, as to universal service, the Commission's central goal should be to apply subsidies only where a customer is unable to afford service. In some cases, as a result of price increases implemented after Phase II relief is obtained, an ILEC's local service charges may exceed the relevant benchmark for universal service purposes. The regulatory response in such cases should not be simply to assume that the end user in question cannot afford the increased rate. Rather, only upon a demonstration that the end user in question cannot afford the higher price (using independent measures such as average income in a particular area), should the universal service payment continue to apply. Otherwise, the universal service reimbursement should be eliminated and the fund size reduced accordingly.

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particular MSA, and ILEC need not ever know any more details regarding CLEC market share.

IV. ABSENT AN ADEQUATE COMPETITIVE SHOWING IN A PARTICULAR AREA, ILECS SHOULD ONLY BE PERMITTED TO GEOGRAPHICALLY DEAVERAGE COMMON LINE ACCESS ELEMENTS WHERE UNBUNDLED LOOPS HAVE BEEN DEAVERAGED; NO DEAVERAGING IS WARRANTED FOR SWITCHING UNDER ANY CIRCUMSTANCES.

The Commission seeks comment on whether it should allow ILECs to geographically deaverage common line and switching charges in Part 69. Notice at ¶¶ 191-199. Both forms of deaveraging pose the potential for anticompetitive behavior and should be permitted only where necessary in order to prevent market distortions. Moreover, such distortions are only likely in the case of loops where unbundled loops have already been deaveraged.

First, permitting geographic deaveraging of loops in the absence of competitive pressures to discipline the ILECs' pricing behavior would create an opportunity for cross-subsidy and exclusionary pricing behavior. The Commission has implicitly acknowledged that ILECs have the incentive to use deaveraging in this manner. For example, in the Fifth R&O the Commission required that each geographic zone for trunking basket services except the highest cost zone must account for at least 15 percent of the ILEC's trunking basket revenues in the study area in question. See Fifth R&O at ¶ 62. This limitation, the Commission explained, is designed to prevent ILECs from designing zones that are "for all practical purposes, specific to particular customers," see id., and to prevent "predatory pricing", see id. at ¶ 63.

Given these risks, the Commission should not apply to common line elements the approach adopted for geographic deaveraging of trunking basket elements. The Commission's decision to relieve ILECs of any obligation to demonstrate that their trunking basket pricing zones accurately reflect cost differences makes it highly unlikely that the Commission's 15 percent minimum will prevent anticompetitive behavior for those services. But the situation would be even more serious if the same rules were applied to common line elements, which are subject to must less competition than trunking basket services. For example, if ILECs were able to raise loop prices in some areas without any market or regulatory check, they could easily do so in a manner that overprices loops in areas with no competition and underprices loops in areas subject to competition. This would obviously make it more difficult for CLECs to compete for local customers.

Moreover, raising loop prices in some areas would not necessarily attract entry, since other factors such as usage patterns, population density, etc. may make entry unattractive even in where substantial increases in loop prices have been implemented. Nor would such conduct necessarily violate the minimum 15 percent revenue rule established for trunking service. Indeed, there is nothing in the rules adopted for trunking basket deaveraging that would prevent an ILEC from raising prices in all but one zone in a study area and then dropping rates precipitously in the narrowly tailored urban area where the ILEC faces competition. The Commission took some (misplaced) comfort in its assumption that geographic zones were not likely to be designed in an anticompetitive manner because "market forces" would prevent abuse. See id. at ¶ 65. But those market forces are largely nonexistent for common line basket services such as the loop.

It follows therefore that the Commission must not adopt geographic deaveraging rules at this time for common line basket elements. The Commission must instead wait until it is sure that predation is unlikely before it permits geographic deaveraging for common line elements. For example, such deaveraging would be appropriate once a carrier has met the trigger for Phase II, as that trigger is defined above. In the face of the fairly extensive entry described above (service offered to 75 percent of customer locations and 15 percent of customer locations actually served by CLECS), it would appear to be quite difficult for the Commission to exploit geographic deaveraging to harm competition.

There is one exception to this general rule, however. It is true that forcing ILECs to retain geographically averaged loop prices in its Part 69 rates at the same time as unbundled loops can be purchased on a geographically deaveraged basis could create opportunities for arbitrage. Thus, TWTC agrees that where prices for unbundled loops have been geographically deaveraged, that Part 69 common line elements should be deaveraged as well. Moreover, the two forms of deaveraging should be follow identical geographic boundaries.

Second, as to switching, there is no basis for geographic deaveraging. Switches cost the same regardless of where they are located, and installation, maintenance and repair also should not vary according to the size of the switch or across geographic areas.[29] There is no basis for allowing ILECs to price their Part 69 switching elements differently in different geographic areas.

If the Commission were to permit such geographic deaveraging, it would offer an unnecessary incentive for the kind of exclusionary pricing mentioned above. That is, the ILECs would have the ability and the incentive to drop prices for traffic sensitive services in areas where they face competition, even though the costs of those services do not vary materially from one area to another. ILECs would recover the cost of such price reductions by raising prices for traffic-sensitive services in other areas. Meanwhile, CLECs, who face competition in all areas where they enter, would not be able to recover the costs associated with lowering prices to meet ILEC discounts. The risk that CLECs would be subjected to this form of predation further reinforces the need to prohibit geographic deaveraging for traffic-sensitive services.

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29 See, e.g., Federal-State Joint Board on Universal Service, Recommended Decision, 12 FCC Rcd 87, ¶¶ 234-235 (1996) (citing evidence that switching costs do not vary by switch size); Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board, Notice of Proposed Rulemaking and Notice of Inquiry, 10 FCC Rcd 12309, ¶ 10 (1995) (citing evidence in comments "that for today's digital switches, the average cost per access line does not vary greatly by switch size (i.e., a digital switch serving 1000 access lines has about the same cost per line as a switch serving 20,000 lines)").

V. THE COMMISSION SHOULD NOT ADOPT A CAPACITY-BASED LOCAL SWITCHING RATE STRUCTURE

The Commission seeks comment on whether it should replace the existing per minute local switching rate structure with a capacity-based rate structure. See Notice at ¶¶ 211-216. Under a capacity-based structure, access purchasers would, for example, pay switching costs based on the number of their trunks that are connected to an ILEC switch. This proposal should be rejected.

As the Commission seems to concede in the Notice (¶ 211), It is fairly well-established that the most efficient rate structure for switching is a peak-load structure under which a positive price is imposed for busy hour use and a price of zero or close to zero applies during off-peak periods.[30] Unfortunately, as also acknowledged in the Notice (¶ 211), true peak load pricing is very difficult to implement. Most importantly, the price difference between peak and non-peak times tends to be large. This gives purchasers a strong incentive to try to maximize use during non-peak times. Such shifts in usage, however, can often result in the peak time shifting to another time period. Shifting peaks can in turn create an ever-changing pricing structure that makes business planning and administration very difficult. See Local Competition First Report and Order at ¶¶ 756-757 (describing the "practical problems" associated with implementing peak load pricing).

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[30] See also Local Competition First Report and Order at ¶ 755 (concluding that peak/off-peak pricing is the most efficient pricing scheme for shared facilities).

While these difficulties have justifiably caused the Commission to look for an alternative to peak-load pricing, it is not at all clear that capacity-based charges would come closer to replicating peak load pricing than the existing per minute rate structure. Consider, for example, a purchaser of access switching that uses a significant amount of capacity, but only during off-peak times. Under the optimal peak-load pricing approach, this carrier would (assuming its use combined with others' did not cause the peak to shift) pay next to nothing for switching. But under the Commission's proposed capacity-based approach, the carrier would pay as much as it would if it were to purchase service during the peak period. Of course, such distortions exist under the existing per minute rate structure, but the point is that capacity-based structures do not necessarily improve matters.

Moreover, in some cases, capacity-based charges would create greater distortions than the per minute rate structure. For example, any capacity-based rate structure would need to employ a minimum measure of capacity, such as a T-1, that is used to quantify a carrier's consumption of switching services. Even if a carrier sends just one minute of traffic over the ILEC switch, the carrier would be required to pay for the entire T-1. If such minimal use (say as a result of spill-over from the carrier's primary access provider) is only consumed during non-peak periods, the resulting distortion would be greater than is the case if the purchasing carrier pays a per minute charge. Again, in the capacity regime the customer pays for the entire circuit while in the per minute regime the customer pays only for one minute. The latter is closer to the efficient off-peak rate.

Furthermore, to the extent that CLECs would have the incentive to match ILEC rate structures for switching by adopting capacity-based charges, they are unlikely to be able to do so where they interconnect with long distance carriers via the ILEC tandem switch. In such interconnection arrangements, CLECs generally build out trunk groups to ILEC tandems so that they can carry the IXC traffic back to the CLEC switch. All interexchange carriers with tandem-switched traffic originating or terminating at the CLEC switch share these trunk groups, thus making circuit-by-circuit capacity charges impractical. Instead, CLECs would be required to aggregate the total amount of capacity used by the carriers, of course adjusting the amount each time more capacity is added, and then bill carriers based on relative use. Such a system, with its complex algorithms, introduces significant changes to CLEC billing that currently uses a fixed per minute charge. Given the huge expense and delay that CLECs have experienced in establishing accurate and reliable billing systems (including compliance with the Commission's Truth-In-Billing requirements), this significant added complexity would make an already daunting entry barrier even higher.

Thus, there is no evidence that capacity-based rates will make the access switching rate structure more likely to cause ILECs to recover their costs in the manner in which they are incurred. Furthermore, such a scheme could impose substantial billing costs on CLECs, thus making entry more costly.

VI. CONCLUSION

The Commission should implement rules reforming its interstate access regime in accordance with these comments.

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